

# Lessons for Financiers and Lessors from *Alpstream v. PK Airfinance*

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*Alpstream v. PK Airfinance*,<sup>1</sup> a recent decision of the **English Commercial Court**, highlights the duties of financiers in the context of aircraft repossessions and the associated power of sale in default scenarios. The case garnered significant mainstream media attention principally because the claimants are controlled by Russian billionaire Alexander Lebedev, who holds controlling interests in newspapers in both Russia and the United Kingdom.

## Facts of Case

Alpstream leased seven **Airbus A320s** (the Aircraft) to Blue Wings, a German airline that filed for insolvency in 2010. The Aircraft were financed by PK Airfinance Sarl (PK). The financing for the Aircraft was cross-collateralized to the financing of certain other aircraft leased to Olympic, a Greek airline (the Caelus Aircraft). Alphastream, an affiliate of Alpstream, has an equity interest in the Caelus Aircraft.

As a result of the Blue Wings insolvency, Alpstream defaulted on the financing of the Aircraft. PK repossessed the Aircraft and conducted a public auction of the Aircraft. At the auction, PK bid on the aircraft and won (there were no other bidders), and subsequently sold the Aircraft to its affiliate GECAS, which leased the Aircraft to JetBlue, a U.S. airline. Alpstream alleged that PK breached its duties as a mortgagee in possession in that it sold the Aircraft to GECAS at less than the price that PK should have achieved as a mortgagee in possession. In addition, Alphastream alleged that because PK failed to take reasonable steps to achieve the best value for the Aircraft, Alphastream's equity interest in the Caelus Aircraft was eroded. It is of note that no party wanted to void the sale from PK to (ultimately) GECAS. Both Alpstream's and Alphastream's claims against PK and GECAS were grounded in the economic tort of "unlawful means conspiracy."

## Unlawful Means Conspiracy

For PK and GECAS to be liable for the tort of unlawful means conspiracy, Alpstream and Alphastream were required to prove that:

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- (a) PK and GECAS conspired to cause Alpstream or Alphastream (as applicable) some kind of harm;
  - (b) the harm was caused by some form of unlawful means; and
  - (c) PK and GECAS intended to cause the harm.

In *OBG Ltd v. Allan*<sup>2</sup> (*OBG*), it was suggested that the intention element (part (c) above) could be shown if the loss was "the obverse side of the coin from the gain to" the aggrieved party. That is, each of PK and GECAS could be liable if it knew its gain was achieved at the cost of Alpstream or Alphastream.

## The Court's Ruling and the Importance of Intent

The court held PK and GECAS liable for unlawful means conspiracy, ruling that:

- (a) PK and GECAS (i) caused economic loss to Alphastream<sup>3</sup> in that its equity interest in the Caelus Aircraft was eroded because the price paid for the Aircraft was insufficient to discharge the debt, breakage costs, remarketing costs, sale costs and the cost of the works done to the Aircraft and (ii) conspired to cause the loss, when GECAS employees instructed PK to repossess the Aircraft and bid for the Aircraft within a certain price range;
- (b) PK acted with willful misconduct (unlawful means) in breach of its duty as mortgagee to Alpstream (and Alphastream) when it failed to arrange for the sale appropriately; and
- (c) the intention element had been met.

The court suggested that the intention element was satisfied in that PK and GECAS acted deliberately with knowledge that their actions would cause a loss as a result. Intention was not discussed in great detail by the judge, and this formulation is different from the "obverse side of the coin" test set out in *OBG*, as there was no reference by the judge to a gain by PK and/or GECAS. While PK and GECAS may have contemplated causing a loss to Alphastream, it might be argued that they were simply focused on acquiring the Aircraft for the purposes of leasing the Aircraft to JetBlue, while minimizing any losses to PK or GECAS. The loss to Alphastream was a consequence of PK's and GECAS's actions, but this result arose only because there was no bidder who offered a higher purchase price at the auction of the Aircraft.

The judge's decision ultimately results in Alphastream suffering a loss anyway, with its equity eroded to a lesser degree than it would have been as a result of the auction-led sale that ultimately transferred the Aircraft to GECAS. Did PK and/or GECAS really intend to cause Alphastream a worse loss than the loss Alphastream was always going to suffer following a repossession? PK and GECAS have recently confirmed that they will appeal the decision in *Alpstream*, and this may be a basis for the appeal.

## Analysis

The *Alpstream* case serves as a useful reminder of the various duties of a financier in a repossession scenario.

### A Mortgagee's Duty to the Mortgagor

First, in a standard default, repossession and sale scenario, a mortgagee's duty is "to behave as a reasonable man would behave in the realisation of his own property,"<sup>4</sup> to take reasonable care to obtain the true market value of the mortgaged property.<sup>5</sup> If there is any question as to the impropriety of any such sale, it is for the mortgagor to prove that such duty has been breached.

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Where it is contemplated that, following repossession, the mortgagee will sell the collateral to a connected person, the duty to the mortgagee is heightened and the burden of proof is reversed so that there is a "heavy duty on [the mortgagee] to show that [it] used its best endeavours to obtain the *best price* reasonably obtainable for its mortgaged property"<sup>6</sup>(emphasis added).

In *Alpstream*, the judge found that this duty extended not only to Alpstream but also to Alphastream, whose interest in the residual of the cross-collateralized equity was eroded by the agreement by PK and GECAS to set a level for the purchase price. In holding PK and GECAS liable for unlawful means conspiracy, the judge did not need to make this finding, and it may be in error. This is because the "unlawful means" element of the tort need not be directed at the person who suffers the intended harm. Perhaps the judge was focused intently on finding that PK and GECAS were liable in the tort so that damages would be payable. A breach of the mortgagee's duty to the mortgagor would otherwise have resulted in the sale being voided.

### **Auctions and Sales to Connected Persons**

In *Alpstream*, PK elected to proceed with the sale of the Aircraft through a public auction. The principal purpose of this, based on the evidence set out in the judgment, was (i) to have a proper, transparent process to transfer the Aircraft from PK to GECAS and (ii) to create a clean break from the debt and the equities in the Aircraft.

It should be noted that the judge found that while the auction itself was not "in any individual respect negligently conducted," there were several factors that a mortgagee should consider when auctioning an aircraft to the public, including:

- (a) ensuring that any improvement to the expected condition of the aircraft is advertised;
- (b) targeting potentially interested parties for a sale;
- (c) pursuing or encouraging parties that have expressed an interest in the sale; and
- (d) taking independent valuation advice, which was relevant in a connected sale.

The judge determined that, in this case, the best approach would have been an indirect private sale from PK to GECAS. Had such a sale occurred, a higher price would have been paid for the Aircraft because GECAS was a willing buyer, the auction of "distressed aircraft" would have been avoided and the sale would have been conducted without the additional expense of an auction. As GECAS was a "special" or "uncommonly motivated" purchaser, it would have needed to pay and be willing to pay more than the market price.

The court's analysis begs the question, Can a properly run auction ever be the correct course of action when there's a connected person bidding? Perhaps yes—but only where the connected person is not uncommonly motivated and the auction is fairly run, obtaining the best price reasonably obtainable.

### **Willful Misconduct**

Pursuant to the relevant mortgage documents, PK was liable to Alpstream only in cases in which PK could be shown to have engaged in wilful misconduct. The judge held that the test was whether the "conduct can be characterised as intentionally doing what [PK] knew to be wrong or recklessly indifferent to whether [its] actions were right or wrong and as to whether loss would result, or whether [it] took a risk which [it] knew [it] ought not to take."

If PK had not engaged in wilful misconduct, would Alphastream have been able to claim? As noted by the judge, *OBG* suggests that Alphastream would not have been able to claim because the unlawful means would not have been actionable by Alpstream.<sup>7</sup>

## Maintenance Works Undertaken

The *Alpstream* ruling also reinforces the right of mortgagees to perform maintenance on an aircraft to prepare it for sale and charge the costs of that maintenance to the mortgagor. Alpstream claimed on a general basis that it should not be liable for works undertaken on the Aircraft that did not "add value" to the Aircraft. This court held Alpstream liable for maintenance costs for two principal reasons:

- (a) the work was undertaken because the Aircraft were returned by Blue Wings in poor condition and not in accordance with the redelivery condition requirements, which Alpstream had agreed to indemnify;
- (b) the work was required to put the Aircraft in the condition required for the leasing to JetBlue, which was incorporated into the judge's calculation for the correct sale price. The works were a condition of the lease, which the sale depended on; the claimants could not claim both (i) a credit for the increased price and (ii) an additional amount reflecting the works that were done to put the Aircraft in the condition required.<sup>8</sup>

## Conclusion

While *Alpstream* raises important questions about the level of intention required on the part of a defendant in the unlawful means torts, the case also serves as a useful reminder of factors that financiers must be aware of in default scenarios:

- (a)** the mortgagee's increased duty to the mortgagor when there are connected sales (from a reasonableness standard to one where best endeavours are required);
- (b)** the reversal of the burden of proof in the context of a sale to a connected person;
- (c)** the requirement that an auction in the circumstances of a potential connected sale, while appearing to be transparent, be run in a fashion that achieves the best obtainable price, which may include specific targeting of potential purchasers and targeted follow-up of persons who have expressed an interest;
- (d)** the limiting to "wilful misconduct" of claims that are actionable against the mortgagee arising under the underlying mortgage or other transaction documents may serve to limit claims arising under the economic torts from third parties; and
- (e)** it is reasonable for a mortgagee to arrange for maintenance work to put an aircraft into the redelivery condition required under the underlying lease documents (even if the works do not "add value" to the aircraft) and additional maintenance work that is reasonable in the context of a sale and onward leasing of the Aircraft.

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<sup>1</sup> *Alpstream AG and others v. PK Airfinance Sarl and another*, [2013] EWHC 2370 (Comm).

<sup>2</sup> *OBG Ltd and another v. Allan and others; Douglas and another v. Hellos! Ltd. and others* (No. 3); *Mainstream Properties Ltd. v. Young and others* [2007] UKHL 21.

<sup>3</sup> Because the debt provided to Alpstream under the financing arrangements was significantly higher than the value of the Aircraft, Alpstream was unable to show economic loss.

<sup>4</sup> *McHugh v. Union Bank of Canada* [1913] AC 299.

<sup>5</sup> *Cuckmere Brick Co. v. Mutual Finance* [1971] CH 949.

<sup>6</sup> *Tse Kwong Lam v. Wong Chit Sen* [1983] 1 WLR 1349, PC.

<sup>7</sup> The judge also noted, however, that there are older cases that suggest otherwise (e.g., *Torquay Hotel Co. Ltd. v. Cousins* [1969] 2 CH 106; *Merkur Island Shipping v. Laughton* [1983] 2 AC 570).

<sup>8</sup> The court did find, however, that GECAS had used new HPT blades when it was perfectly possible to use reconditioned blades in the engines, given that the Aircraft were on the ground and there was no urgency in repairing the Aircraft. The mortgage account was increased by the difference in the price paid for new blades and the price of reconditioned blades.

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